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In the Supreme Court of the United States

OCTOBER TERM, 1953

No. 579

KENDALL A. YOUNG AND ELISABETH R. YOUNG,
PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 13-18) is not officially reported. The opinion of the Court of Appeals (R. 20) is reported at 208 F. 2d 795.

JURISDICTION

The judgment of the Court of Appeals was entered on December 9, 1953. (R. 21.) The petition for a writ of certiorari was filed on February 5, 1954. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED

Whether the difference between the cost basis of stock in a corporation and the fair market value of the assets received in complete liquidation is taxable in the year such assets were received.

STATUTE AND REGULATIONS INVOLVED

The pertinent parts of the statute and regulations involved are set forth in the Appendix, *infra*, pp. 8-9.

STATEMENT

This case involves an asserted deficiency in personal income tax for the calendar year 1945. The facts, as stipulated by the parties (R. 11-13) and as found by the Tax Court (R. 13-18), may be summarized as follows:

Taxpayers, during the taxable year 1945, were husband and wife, and residents of the State of Maryland. Taxpayer Kendall A. Young (hereinafter referred to as taxpayer) was a certified public accountant and a practicing tax attorney. (R. 11.)

In 1944, the taxpayer acquired a one-third interest in the common stock of a Maryland corporation known as Better Housing, Inc., engaged in the building of approximately 150 houses for war workers. Taxpayer was given his one-third interest in the common stock of Better Housing, Inc., without consideration. The cost basis of such stock to taxpayer was zero. The last of the approximately 150 houses was completed in the early part of 1945, and the houses were thereupon rented. Subsequent to completion, unsuccessful efforts were made by

the corporation to sell the houses to their occupants. (R. 11.)

In the summer of 1945, further unsuccessful attempts were made by the corporation to sell the houses as a block. Upon the failure of these efforts, differences of opinion regarding future operations by the corporation arose among the stockholders and it was decided by them to liquidate the corporation completely and to distribute the assets in kind to each of the three stockholders, including taxpayer, subject to liabilities. (R. 11.)

The machinery, tools, fixtures, and automobiles belonging to the corporation were sold in the early fall of 1945. By appropriate action of the board of directors at a meeting held on November 15, 1945, Better Housing, Inc., was dissolved. All the assets of the dissolved corporation in the form of cash, accounts receivable subject to accounts payable, and 150 houses and lots subject to construction mortgages were completely distributed to the three stockholders, including taxpayer, on December 1, 1945. (R. 12.)

On account of his one-third interest in Better Housing, Inc., taxpayer received on December 1, 1945, 50 houses and lots and certain miscellaneous assets in the form of cash and accounts receivable. The fair market value on December 1, 1945, of the houses and lots subject to mortgages received by taxpayer on liquidation of Better Housing, Inc., was determined by the Commissioner in his notice of deficiency as $50,742.51, and the fair market

value of certain miscellaneous assets consisting of cash and accounts receivable subject to accounts payable received by the taxpayer was determined by the Commissioner in his notice of deficiency as $2,041.05, totaling $52,783.56. (R. 12.)

Taxpayers filed a joint income tax return for the calendar year 1945. They failed to report any part of the amount received on liquidation of Better Housing, Inc., as income for such year. (R. 12.)

In redetermining taxpayers' income for the calendar year 1945, the Commissioner included therein as additional income 50 percent of $52,783.56 ($26,391.78) as a long-term capital gain. (R. 12.)

In 1946, taxpayer sold 12 of the houses received on the liquidation of Better Housing, Inc., and reported income derived from such sales on his return of income for such year, either on the completed sale or on the installment sale basis. (R. 12-13.)

The Tax Court held that the amount received by the taxpayer for his stock in the complete liquidation of Better Housing, Inc., is to be treated as in full payment thereof, and that the difference between the taxpayer's basis and the fair market value of the property received is to be taxed as a long-term capital gain in 1945. (R. 14-17.) The Court of Appeals affirmed the Tax Court's decision. (R. 20-21.)

ARGUMENT

1. The Court of Appeals was correct in determining that the difference between the basis of tax-

payer's capital stock and the fair market value of the property received by him upon the liquidation of Better Housing, Inc. was to be treated as capital gain. The holding of the court below is supported by the decision of this Court in *Hellmich* v. *Hellman,* 276 U.S. 233, and *White* v. *United States,* 305 U.S. 281. Section 115 (c) of the Internal Revenue Code (Appendix, *infra,* pp. 8-9) like its precursor, Section 201 (c) of the Revenue Act of 1918, c. 18, 40 Stat. 1057, as construed in *Hellmick* v. *Hellman, supra,* placed shareholders' gains from liquidations upon the same basis, for computation of the tax, as gains from the sale or exchange of property.[1] The reports of the Congressional Committees discussing Section 201 (c) of the Revenue Act of 1924, c. 234, 43 Stat. 253, make it plain that that section, the relevant portion of which is identical with Section 115 (c) of the Internal Revenue Code, was intended to require gains upon corporate liquidations to be brought into the computation of the tax in the same manner as corresponding gains from sales.[2]

2. The statutory provisions were properly applied in this case. Amounts distributed in complete liquidation under the general rule provided by Section 115 (c) are by express direction of the statute

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[1] Section 201(c) of the 1918 Act, omitted from the Revenue Act of 1921, reappeared in the 1924 Act and was continued, so far as now relevant, in the form in which it later appeared in Section 115(c) of the Revenue Acts of 1928, c. 852, 45 Stat. 791; 1932, c. 209, 47 Stat. 169; 1934, c. 277, 48 Stat. 680; 1936, c. 690, 49 Stat. 1648, and the Internal Revenue Code.

[2] S. Rep. No. 398, 68th Cong., 1st Sess. pp. 11-12 (1924) (1939-1 Cum. Bull. (Part 2) 266, 274); H. Rep. No. 179, 68th Cong., 1st Sess., pp. 11-12 (1924) (1939-1 Cum. Bull. (Part 2) 241, 249-251).

"treated as in full payment in exchange for the stock". Accordingly, under the general rule for corporate liquidation (Section 115 (c) as explained by Treasury Regulations 111, Section 29.115-5 (Appendix, *infra*, p. 9)), the transaction is regarded as a sale or exchange of the stock for the liquidation distribution, the resulting gain or loss is treated as capital gain or loss governed by and subject to the limitations of Section 117 of the Internal Revenue Code. Here, therefore, when the taxpayer "sold" his stock to the corporation in 1945 for $52,783.56, he realized a gain in that amount and was required to report the sum of $26,391.78 as a long-term capital gain.[3]

3. There are no conflicting decisions requiring resolution by this Court. *Eisner* v. *Macomber*, 252 U.S. 189, relied on by the taxpayer (Pet. 7-8), in no way implies that the difference between the basis of taxpayer's capital stock and the fair market value of the property received by him upon the liquidation of Better Housing, Inc., constitutes unrealized income. Rather, that case, in so far as is pertinent here, held (p. 207):

> "Income may be defined as the gain derived from capital, from labor, or from both combined," provided it be understood to include profit gained through a sale or conversion of capital assets, to which it was applied in the *Doyle Case*, [247 U.S.] 183, 185 * * *.

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[3] See *Osenbach* v. *Commissioner*, 198 F. 2d 235 (C.A. 4th); *Helvering* v. *Syndicate Varieties*, 140 F. 2d 344 (C.A. D.C.).

CONCLUSION

The decision below is correct. There is no conflict of decisions. The petition for a writ of certiorari should therefore be denied.

Respectfully submitted,

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MARCH, 1954.

APPENDIX

Internal Revenue Code:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U.S.C. 1946 ed., Sec. 22.)

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

* * * * *

(c) [as amended by Sec. 147 of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Distributions in Liquidation.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under

section 111, but shall be recognized only to the extent provided in section 112. * * *

* * * * *

(26 U.S.C. 1946 ed., Sec. 115.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

Sec. 29.115-5. *Distributions in Liquidation.* —Amounts distributed in complete liquidation of a corporation are to be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation are to be treated as in part of full payment in exchange for the stock so canceled or redeemed. The gain or loss to a shareholder from a distribution in liquidation is to be determined, as provided in section 111 and section 29.111-1, by comparing the amount of the distribution with the cost or other basis of the stock provided in section 113; but the gain or loss will be recognized only to the extent provided in section 112, and shall be subject to the conditions and limitations provided in section 117.

* * * * *

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